

**ANNUAL REPORT
OF THE
PENSION MANAGEMENT OVERSIGHT
COMMISSION**



**Indiana Legislative Services Agency
200 W. Washington Street, Suite 301
Indianapolis, Indiana 46204**

November, 2003

INDIANA LEGISLATIVE COUNCIL

2003

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PENSION MANAGEMENT OVERSIGHT COMMISSION

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Staff

Peggy Piety
Attorney for the Commission

James Sperlik
Fiscal Analyst for the Commission

A copy of this report is available on the Internet. Reports, minutes, and notices are organized by committee. This report and other documents for this Committee can be accessed from the General Assembly Homepage at <http://www.state.in.us/legislative/>.

I. STATUTORY AND LEGISLATIVE COUNCIL DIRECTIVES

The Indiana General Assembly enacted legislation (IC 2-5-12) directing the Pension Management Oversight Commission (PMOC) to oversee public retirement funds in Indiana. The Commission is required to do the following:

- (1) Study the investment and management practices of the boards of the public retirement funds.
- (2) Determine what constitutes adequate wage replacement levels at retirement (including benefits from public retirement funds and social security) for public employees.
- (3) Study the impact of federal law and proposals concerning pensions, annuities, and retirement benefits.
- (4) Study the retirement funds established under IC 36-8.
- (5) Study methods and levels of funding for public retirement funds.
- (6) Study other topics as assigned by the Legislative Council.
- (7) Study other topics as directed by the Commission's chair.

The Commission consists of twelve members: four Representatives, four Senators, and four lay members who must be experts in the areas of finance, investments, or pension fund management. The chair of the Legislative Council appoints the chair of the Commission.

The Legislative Council assigned the following additional responsibilities to the Commission in 2003:

- (1) Study the funding status for police and fire pension funds.
- (2) Review the state's deferred compensation program.

II. INTRODUCTION AND REASONS FOR STUDY

The Commission determined that it would review the following issues:

A. Public Pension Fund Administrative Issues

The Commission received an update on current activities undertaken by the Public Employees' Retirement Fund (PERF) in the areas of investments, customer service, recent events, security measures, workload, and communications. The Commission also received the annual fiscal operations report of the Teachers' Retirement Fund (TRF).

B. The State's Deferred Compensation Program

The Commission received an update on the administration, investment, and performance of the

Indiana Deferred Compensation Plan, a topic assigned by the Legislative Council.

C. Judges' Retirement Fund Issues

The Commission heard testimony to determine whether to recommend: (1) a cost of living adjustment (COLA) for members of the 1985 Judges' Retirement Fund; and (2) the addition of full-time magistrates as members of the 1985 Judges' Retirement Fund.

D. Funding of Police Officer and Firefighter Pension Funds

The Commission heard testimony concerning the status of the funding for pre-1977 Fund police officer and firefighter pension liabilities mandated under state statutes, a topic assigned by the Legislative Council.

III. SUMMARY OF WORK PROGRAM

The Commission met three times during the interim following the conclusion of the 2003 session of the General Assembly. All three meetings were held at the State House in Indianapolis.

At the first meeting, held on September 12, 2003, the Commission heard testimony concerning the following issues: (1) the funding status of the police and firefighter pre-1977 pension funds; (2) the review of the State's Deferred Compensation Program; (3) a COLA for members of the 1985 Judges' Retirement Fund; and (4) the addition of full-time magistrates to the 1985 Judges' Retirement Fund.

At its second meeting, held on October 21, 2003, the Commission heard testimony concerning the following issues: (1) an update on the current activities of the Public Employees' Retirement Fund; (2) the funding status of the police and firefighter pre-1977 pension funds; (3) the review of the State's Deferred Compensation Program; (4) a COLA for members of the 1985 Judges' Retirement Fund; and (5) the addition of full-time magistrates as members of the 1985 Judges' Retirement Fund.

At its third meeting, held on October 30, 2003, the Commission accepted TRF's 2003 fiscal operations report.

IV. SUMMARY OF TESTIMONY

A. Public Pension Fund Administrative Issues

The Commission heard testimony from Craig Hartzer, Executive Director of PERF, concerning recent PERF activities in six areas: investments, customer service, recent events, security measures, workload, and communications.

Mr. Hartzer reviewed PERF's investment policy and actual investments. The performance summary for the Consolidated Retirement Investment Fund (CRIF) indicated that, as of June 30, 2003, the total fund's market value (gross of fees) was \$9.7 billion. The investment return for the last six months was 10.3%. The majority of participants have chosen the Guaranteed Fund investment option for their Annuity Savings Accounts (ASA). The Guaranteed Fund had a total market value of \$1.6 billion. The Police and Fire Pension Relief Fund, as of June 30, 2003, had a total market value of \$467.6 million and a year-to-date investment return of 6.2%.

PERF's goal is to provide world class customer service to its members, beneficiaries, and employers. PERF is taking several actions to improve customer service, including actions to reduce to 60 days the time between a member's retirement and the payment of the first benefit check. Additional customer service personnel have been hired, and PERF is remodeling space on the first floor of its building to add a customer service center. PERF's customer service initiatives with employers include employer advisory groups, electronic reporting, and outreach services.

Mr. Hartzer provided a status report on the cases involving former PERF employees. As a result of learning that the temporary agencies do not perform background checks on employees sent to PERF, PERF has eliminated the use of temporary agencies.

PERF is pursuing security measures in three areas: cyber security, operational security, and physical security. PERF has received a report from a global cyber security firm that analyzed PERF's technical operations, and in partnership with TRF, PERF is implementing the study's recommendations. PERF also is conducting an internal audit to review PERF's internal controls. It is performing a monthly "death match" against all inactive accounts with a positive balance and is in the process of "freezing" those accounts. PERF also has adopted a policy of conducting Indiana criminal history background checks and fingerprinting for all new hires. PERF is exploring the use of a membership number as an identifier rather than using the member's Social Security Number. In addition, PERF is developing a disaster recovery plan and limiting unauthorized public access to PERF's building.

PERF communicates with its members by means of annual reports, quarterly statements of account, newsletters, its call center, and the PERF web site.

Mr. Hartzer reported on the implementation of recent PERF legislation, including the \$180 minimum monthly benefit, pre-tax voluntary contributions of up to 10% of a member's compensation, and the pilot program for the Legislators' Defined Contribution Plan.

The Commission accepted TRF's 2003 Fiscal Operations Report distributed by Dr. William Christopher, Executive Director of TRF.

B. The State's Deferred Compensation Program

Jeffrey Heinzmann, Deputy Auditor of Policy and Legal Counsel, Auditor of State's Office, testified about the Indiana Deferred Compensation Plan (the Plan). Mr. Heinzmann identified himself as the Secretary of the Deferred Compensation Committee (the Committee) and the Auditor of State's appointment to the Committee.

Mr. Heinzmann reported that as of August 31, 2003, the Plan's total assets were \$555,444,736. Plan participants remain heavily invested in conservative options. As of August 31, 2003, 62.12% of the Plan's assets were invested in the Indiana Stable Value Fund (ISVF). On an ongoing basis, the ISVF receives nearly half of the monthly contributions to the Plan. ING is the third party administrator for the Plan.

The Committee is negotiating a contract with Buck Consultants LLC for investment consulting services to accomplish three separate tasks: (1) an evaluation and quarterly reports to the Committee concerning the performance and management of the investment options available under the Plan; (2) assistance to the Committee in the drafting of an Investment Policy Statement; and (3) assistance to the Committee in the replacement of the Plan's investment options should that be advisable.

Neither the Auditor of State nor the Committee are seeking legislative changes to the Plan at this time.

C. Judges' Retirement Fund Issues

Judge Nancy Vaidik, President of the Indiana Judges Association, and a judge on the Indiana Court of Appeals, requested that the Commission again consider recommending legislation establishing a COLA for members of the 1985 Fund. She testified that the earlier judges' plan does have a COLA.

Staff explained Preliminary Draft 3308 which would provide a COLA for participants, survivors, and beneficiaries of the 1985 Judges' Retirement Fund at the same percentages and under the same conditions as the monthly benefit is increased for PERF members.

Ken Abbott, Clark County magistrate, requested that the Commission consider recommending legislation to add full-time magistrates to the 1985 Judges' Retirement Fund. Magistrate Abbott testified about his duties as a magistrate. In most respects, he is performing the same duties as a judge. He testified that he left a successful law practice to become a full-time magistrate and since then has been funding his retirement plan out of his own pocket. He believes that fairness requires that magistrates receive the same treatment as judges.

Staff explained Preliminary Draft 3315 which would allow a person serving as a full-time magistrate on July 1, 2004, and require a person who begins serving as a full-time magistrate

after that date, to become a participant in the judges' 1985 benefit system. It also would allow magistrates who are participants in the judges' 1985 benefit system to purchase, at full actuarial cost, service credit for prior service covered by an Indiana public employees' retirement fund.

D. Funding of Police Officer and Firefighter Pension Funds

Mary Beth Braitman of Ice Miller briefly reviewed the actions taken by the General Assembly, beginning in 1977, to help control the growth of property taxes levied by municipalities for pre-1977 fund police officer and firefighter pension liabilities mandated under state statutes.

In 1977, the Pension Relief Fund (Relief Fund) was created along with the 1977 Police Officers' and Firefighters' Pension and Disability Fund (1977 Fund) to assist cities and towns with the burden of paying police and fire pensions from the pre-1977 pension funds. Cigarette tax and alcohol tax revenues were dedicated to the Relief Fund. The revenues were distributed under the "k" formula. The 1977 Fund also offered police officers and firefighters who were hired before May 1, 1977, a one-time opportunity to "convert" their membership from a pre-1977 fund to the 1977 Fund. In 1981, the General Assembly provided additional relief under a supplemental formula called the "m" formula.

In 1989, \$10,000,000 annually in lottery revenues was dedicated to funding the Relief Fund distributions using the "k" formula. In 1996 and 1997, an additional \$100,000,000 was appropriated to the Relief Fund from the state general fund. In 1999, an additional \$20,000,000 annually from lottery revenues was dedicated to the "m" formula.

On October 1, 1998, the General Assembly shifted from municipalities to the 1977 Fund the responsibility for paying the benefits for "converted" members who were retired or disabled before July 1 1998, removing approximately \$250,000,000 in unfunded liability from the pre-1977 plans.

In 2001, the General Assembly enacted certain changes to the Relief Fund structure. First, inequities in the state pension relief formulas were corrected to ensure that the Relief Fund contributed to each city and town a minimum of 50% of the pre-1977 pension fund payments made through December 31, 2007, as long as the city or town maintains its 1998 level of payments according to a maintenance of effort test. Secondly, the funding cycle for Relief Fund payments was advanced to provide current funding of state relief for local pension costs. Finally, municipalities were authorized to leave funds on deposit in the Relief Fund in order to receive a greater return on investments than was available otherwise. Municipalities may withdraw these funds once each year.

Also in 2001, the General Assembly authorized the transfer of interest earnings from the Public Deposit Insurance Fund to the Pension Distribution Fund. Each year from 2001 through 2011, municipalities receive a distribution from the Pension Distribution Fund to help them meet

benefit payment obligations under the pre-1977 pension funds.

In 2002, a deferred retirement option plan (DROP) was authorized for police and firefighter pension funds. Municipalities were provided a levy limit exception for the non-reimbursed portion of DROP lump sum payments.

Doug Todd of McCready & Keene, actuaries for the police and fire pension funds, testified about a chart that he had prepared showing the Relief Fund's share and the municipalities' share of the projected distribution of benefit payments under the current statutes for Indiana municipal police and fire pension plans whose members were hired before May 1, 1977. He noted four points of interest shown on the chart:

(1) There is a dip in the distribution in 1999, because the responsibility for benefits paid to nonactive "converted" members was shifted to the 1977 Fund.

(2) Municipalities did not fund any of the 2001 distribution, because the state made: (a) a double distribution to establish current year funding for state relief; and (2) a make-up distribution to ensure that the Relief Fund paid at least 50% of each municipality's pension liability for 1998 through 2000.

(3) In 2008, the cities' share of the distribution will increase, because the state 50% funding relief provision expires December 31, 2007.

(4) The "Gray Area" of the chart shows a shortfall of \$ 103.6 million (present value as of January 1, 2003), because of the exhaustion of the Relief Fund. The shortfall will occur because there will not be enough money to fully fund the "m" formula. Without any changes, the shortfall will become the municipalities' responsibility. The chart assumes five percent salary increases each year. If the increases are less, the shortfall amount will be smaller.

Matt Brase of the Indiana Association of Cities and Towns (IACT), Kokomo Mayor Jim Trobaugh, current IACT president, Tom Miller representing the Indiana Association of Firefighters, and Leo Blackwell representing the Fraternal Order of Police, all expressed appreciation for the legislators' past support, but indicated that the funding problems have not been solved.

V. COMMITTEE FINDINGS AND RECOMMENDATIONS

The Commission made the following recommendations:

(1) The Commission by a vote of 8-2 recommended the introduction of Preliminary Draft 3308 which would add IC 33-13-10.1-15 to provide a COLA for members of the 1985 Judges' Retirement Fund.

(2) The Commission by a vote of 8-2 recommended the introduction of Preliminary Draft 3315 which would amend IC 33-4-7-12 and IC 33-13 to add full-time magistrates as members of the 1985 Judges' Retirement Fund.

(3) The Commission adopted its final report by a vote of 9-0.

WITNESS LIST

September 12, 2003

Mary Beth Braitman, Ice Miller
Doug Todd, McCready & Keene
Matt Brase, Indiana Association of Cities and Towns
Mayor Jim Trobaugh, City of Kokomo
Tom Miller, Indiana Association of Firefighters
Leo Blackwell, Fraternal Order of Police
Jeffrey Heinzmann, Deputy Auditor of Policy and Legal Counsel, Auditor of State of Indiana
Judge Nancy Vaidik, Indiana Court of Appeals, President, Indiana Judges Association
Magistrate Ken Abbott, Clark County, Indiana

October 21, 2003

Craig E. Hartzer, Executive Director, Public Employees Retirement Fund
Tom Miller, Indiana Association of Firefighters
Matt Brase, Indiana Association of Cities and Towns
Jeffrey Heinzmann, Deputy Auditor of Policy and Legal Counsel, Auditor of State of Indiana
Doug Todd, McCready & Keene

October 30, 2003

Dr. William Christopher, Executive Director, Indiana State Teachers' Retirement Fund